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Federal Communications Commission

WASHINGTON, D.C.

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

In the Matter of	)	
	)	
Implementation of Section 301(j)	)	
of the Telecommunications Act of 1996	)	CS Docket No. 96-57
	)	
Aggregation of Equipment Costs	)	
By Cable Operators	)	

COMMENTS OF TELE-COMMUNICATIONS, INC.

WILLKIE FARR & GALLAGHER
Three Lafayette Centre
1155 21st Street, N.W.
Suite 600
Washington, D.C. 20036
(202) 328-8000

Its Attorneys

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Tele-Communications, Inc. ("TCI") hereby submits its comments on the Notice in the above-captioned proceeding.[1]

I. INTRODUCTION AND SUMMARY

Congress adopted the equipment averaging provision to reduce the cost of advanced technologies for consumers. Congress recognized that the current regulations could make sophisticated new equipment "too expensive for most consumers."[2] Thus, it created a new methodology to enable cable operators "to allocate

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1 In the Matter of Implementation of Section 301(j) of the Telecommunications Act of 1996, Aggregation of Equipment Costs, CS Docket No. 96-57, FCC 96-117 (released March 20, 1996) ("Notice").

2. H.R. Rep. 204, 104th Cong., 1st Sess. 107-108 ("House Report").

the costs of [advanced] equipment in a manner that reduces the price for consumers."[3] Specifically, Congress allowed cable operators to average consumer equipment costs in two ways:

- Categorical Averaging - Averaging equipment into broad categories, regardless of the level of functionality; and

- Geographic Averaging - Averaging across broad geographic areas, including franchise, system, regional, and company level.

In order to implement congressional goals, TCI proposes the following approach:

CATEGORICAL AVERAGING

- The Commission should adopt the "broad categories" test contained in Section 301(j) of the 1996 Act. Under this test, initially there would be three categories of equipment for averaging purposes, corresponding to the three types of cable customer equipment recognized in the Commission's existing rules -- converter boxes, remote controls, and inside wiring. Thus, for example, a cable operator may average different types of converter boxes.

- However, consumer technology is evolving rapidly and the rules should be flexible enough to permit new types of equipment to be included in these categories.

- The proposed "primary purpose" test should not be adopted for the following reasons: (1) Section 301(j) allows averaging "regardless of the level of functionality" of the equipment, yet the "primary purpose" test could be construed as focusing on functionality; (2) the primary purpose test may inadvertently limit the benefits of averaging in contravention of congressional intent; and (3) particularly in the future as equipment becomes more complex and multi-

[3] Id. at 108. The legislative history identifies digital boxes as one example of the type of advanced customer equipment Congress intended to assist in terms of streamlined deployment. Id. However, equipment averaging is not limited to digital boxes. Rather, it represents a broad congressional mandate to facilitate the rapid deployment of "new technology." Id.

purpose, disputes will arise about the "primary" purpose of a given piece of equipment.

GEOGRAPHIC AVERAGING

- TCI supports the proposed amendment of the Commission's rules to permit equipment cost averaging at the franchise, system, regional, or company level.

- In order to promote administrative, marketing, and regulatory efficiencies, the Commission should use its discretion to allow installation costs (and thus the hourly service charge) to be averaged on a franchise, system, regional, or company basis. Moreover, such averaging is necessary to allow cable operators to satisfy the 1992 Cable Act requirement that customer equipment be priced at the same level at which equipment costs are aggregated. By contrast, the Notice's proposal to limit averaging of installation costs will cause multiple prices for the same equipment to be charged throughout the geographic area over which the equipment is averaged.

EQUIPMENT USED BY BASIC-ONLY CUSTOMERS

- The limitation on categorical averaging applies to basic-only customers, not to a particular type of equipment. Thus, if a basic-only customer and a CPST customer use the same equipment (as is often the case), a cable operator may average the equipment used by the CPST customer, but not the equipment used by the basic-only customer.

- The Commission should adopt TCI's proposal to allow cable operators to create a standard averaged equipment price for basic-only customers that does not subsidize more sophisticated equipment used by non-basic-only customers.

- TCI supports the Commission's proposal that the costs for equipment used by basic-only customers may be averaged on a geographic basis. If such geographic averaging is not permitted, significant administrative, marketing, and regulatory inefficiencies will result.

II. CATEGORICAL AVERAGING

A. The Commission Should Adopt the "Broad Categories" Test Contained in the 1996 Act.

Section 301(j) directs the Commission to "allow cable operators ... to aggregate ... their equipment costs into broad categories, regardless of the level of functionality of the equipment within each such broad category." Thus, Congress already has established the test for categorical averaging, i.e., equipment in the same broad category may be averaged. In addition, the provision is clear that the Commission may not consider the "level of functionality" of the equipment within each broad category.

In essence, the statutory "broad categories" test focuses on the type of equipment, rather than the functionality of the equipment. For example, under the Commission's current rules, there are three types of customer equipment -- converter boxes, remote controls, and inside wiring.[4] Each of these types of equipment constitutes a "broad category" under section 301(j). Indeed, section 301(j) actually sets out "converter boxes" as a specific equipment type that may be averaged ("cable operators [may] aggregate their equipment costs into broad categories, such as converter boxes ....") (emphasis added). Thus, under the broad categories test, a cable operator may average different types of converter boxes (including any integrally related

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[4] 47 C.F.R. § 76.923(a).

ancillary equipment, such as jumpers), regardless of the level of functionality among such boxes.

However, the Commission should maintain a flexible approach with respect to the current equipment categories. Technology is evolving rapidly. Neither the industry, nor the Commission can anticipate the equipment that may in the future need to be averaged in order to satisfy Congress's goal of facilitating the deployment of advanced technology at prices most consumers can afford. It is therefore critical that the Commission allow new types of equipment to be placed in the current categories.

For example, cable operators at some point may want to provide consumers with additional options for interacting with their cable service, such as through a keyboard or a wireless mouse. When the operator deploys this advanced technology, it should be allowed to broaden its existing remote control category to include the new equipment. Similarly, when new types of advanced boxes are designed and developed for use in cable systems (such as the component modules that will be supplied by cable operators for use with the Decoder Interface[5]), the "converter box" label may need to be broadened to allow such new technology to be averaged with other boxes that are used to receive services delivered over the cable system. Forcing cable operators to create a new equipment category each time such

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[5] See Equipment Compatibility Reconsideration Order, ET Docket No. 93-7 FCC 96-129 (released April 10, 1996), at ¶¶ 38-39).

technological developments occur would contravene both the plain meaning of section 301(j) to allow categorical averaging for broad categories of equipment and Congress's clear objective to reduce the lease price of such new equipment in order to facilitate its rapid deployment.

B. The Primary Purpose Test is Unnecessary and May Lead to an Impermissible Focus on the Equipment's Functionality.

The Notice proposes that the determination of which equipment costs may be included in a broad category for averaging will be based on the equipment's "primary purpose:"

> [C]ustomer, equipment, except equipment used by basic-only subscribers, that is used for the same purpose may be aggregated into the same broad category and priced at the same rate, regardless of the level of functionality."[6]

TCI is concerned that the primary purpose test could inadvertently limit the scope of equipment averaging, complicate the regulatory review process, and confuse consumers.

Consumer equipment typically has multiple purposes or functions and this will likely increase in the future as equipment becomes more complex in order to support advanced interactive uses. For example, even today, boxes perform any of a number of multiple functions, such as channel selection, descrambling, volume control, parental control, video program guide, and pay-per-view ordering. In the near future, a number

[6] Notice at ¶ 9.

of other new functions will be added to this list, including converting signals from digital to analog. Thus, a primary purpose test could limit the operator from averaging where two pieces of the same type of multi-purpose equipment have different primary purposes. Moreover, the primary purpose test will create uncertainty and engender disputes as parties debate what is the primary purpose of a piece of equipment that has multiple purposes.

Finally, focusing on the "purpose" of a piece of equipment is, in effect, focusing on the equipment's various functions and analyzing which function is most important. However, the Act specifically prohibits such an analysis in that averaging may take place "regardless of the level of functionality."

If the Commission intended that under the primary purpose test categorical averaging will be permitted as long as the equipment is of the same type (e.g., converter box or remote in the near term), it may be that the difference between its proposed test and the "broad categories" test is purely semantic. However, if this is the case, the Commission need not adopt the primary purpose test, since Congress has already codified the "broad categories" test, and there is no reason for the Commission to come up with a new label. This is particularly true in light of the possibility that the primary purpose test could be interpreted in ways that unnecessarily limit averaging and increase the potential for uncertainty and disputes.[7]

III. GEOGRAPHIC AVERAGING

A. TCI Supports Removal of the April 3, 1993 Restriction on Geographic Averaging.

TCI agrees that the Commission should: (1) amend its rules to specifically permit geographic averaging at the franchise, system, regional, or company level; and (2) eliminate the current restriction which allows such geographic averaging only in a manner consistent with an operator's practices on April 3, 1993.[8] These rule changes are necessary to implement congressional intent to allow cost aggregation at higher organizational levels without restriction.

B. The Commission Should Allow Geographic Averaging of Installation Costs on a Franchise, System, Regional, and Company Level.

1. The 1996 Act Does Not Preclude the Commission From Allowing Cable Operators to Broadly Average Installation Costs.

The Notice tentatively concludes that "Congress did not intend that cost aggregation be permitted to the same extent for

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[7] Nor should the Commission adopt a definition for "level of functionality." See Notice at ¶ 8. By defining this term, the Commission would be acting directly contrary to section 301(j) which precludes any inquiry into the "level of functionality" when establishing broad categories of equipment to be averaged.

[8] See Notice at ¶ 11.

installation charges."[9] It bases this conclusion on the fact that "section 301(j) refers only to equipment and not to installations, whereas the 1992 Cable Act separately mentions installations."[10] TCI believes that the Notice asks the wrong question with respect to congressional intent. The issue is not whether Congress empowered the Commission to allow installation averaging to the same extent as equipment averaging. Rather, the question is whether anything in this provision removes the Commission's existing discretion to allow broad geographic averaging of installation costs. The answer to this question is no.

Prior to enactment of the 1996 Act, the Commission had authorized geographic averaging of installation costs for approximately 20% of the cable industry in the Continental and Time Warner Social Contracts.[11] Thus, at the time of the enactment of the 1996 Act, Congress knew the Commission had authorized installation averaging, yet no where does the Act curtail this Commission discretion.

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9 Id.

10 Id.

11 See Continental Social Contract Order, 11 F.C.C.R. 299, at ¶¶ 30-32 (1995) (holding that averaging of installation costs on a state-wide and region-wide basis is permissible); Time Warner Social Contract Order, FCC 95-478 (released November 30, 1995), at ¶¶ 40-41 (allowing region-wide averaging of installation costs).

The Commission appears to recognize this fact in its proposal to allow a restricted level of geographic averaging for installation costs. However, unless the Commission uses its discretion to fully authorize cable operators to geographically average installation costs on the same level as equipment costs, it will create many inefficiencies, frustrate the 1992 Cable Act's requirement of pricing equipment at the same level at which costs are aggregated, and impair the achievement of section 301(j)'s principal objectives.

2. There are Significant Public Policy Reasons Why the Commission Should Use Its Authority to Allow Installation Averaging to the Same Extent as Equipment Averaging.

a. Since the Hourly Service Charge and the Equipment Lease Charge Are Integrally Related, Limits on Installation Averaging Will Limit the Benefits of Equipment Averaging.

Limiting the geographic scope of installation averaging will effectively limit the benefits of equipment averaging. This is so because an operator's installation costs are used to derive the operator's hourly service charge ("HSC"). The HSC, in turn, is used to calculate the lease charge for a piece of customer equipment. Specifically, the monthly lease charge is calculated as follows:[12]

$$\text{Monthly Charge} = \frac{\text{UCE} + (\text{HSC} \times \text{HR})}{12}$$

Thus, a limitation on averaging of installation costs necessarily produces different HSCs. Different HSCs will produce different lease charges using the FCC Form 1205. Therefore, limiting averaging of installation costs to small geographic areas will effectively limit the benefits of equipment averaging as well.

Most notably, this disjunction between geographic averaging for equipment and geographic averaging for installation/HSC means that the cable operator will not be able to establish a single uniform price for any of its customer equipment. In fact, the operator would be forced to maintain potentially hundreds of different prices for the same broad category of equipment across different geographic areas. Each separate price would require a separate Form 1205. For example, TCI alone would likely be forced to maintain over 300 FCC Forms 1205 under the Commission's proposal, each with a separate possibility for regulatory review, challenge, and appeal.[13] The Commission has consistently

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[12] HR = average hours repair per year and UCE = average annual unit cost of the equipment. See 47 C.F.R. §§ 76.923(f, g).

[13] The Notice proposes geographic averaging of installation costs in areas where the costs of providing installation are "substantially similar." However, this approach could create more problems than benefits. The operator would still be required to perform all calculations for installation costs at the local level to determine if the costs across various **(continued ...)**

recognized the benefits of uniform pricing achieved through geographic averaging,[14] and should once again facilitate the realization of these benefits by allowing installation costs to be averaged at the same level as equipment costs.

b. Limiting Averaging of Installation Costs Undermines the 1992 Cable Act's Requirement that Equipment Charges Be Based on the Operator's Actual Costs.

The Notice indicates that the actual cost standard requires equipment charges to be based "on the same aggregation level as their costs" and proposes to codify this requirement in its rules.[15] However, as noted above, a limitation on averaging of

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(... continued)

franchises are "substantially similar" and therefore eligible for averaging. In addition, the "substantially similar" definition would likely engender numerous disputes over what costs are "substantially similar." This problem would be further compounded by the fact that all cable systems are different and operate on different cost structures. Thus, what may be substantially similar for one operator, or for one regulator, may not be so for another.

[14] See Continental Social Contract Order, 11 F.C.C.R. 299, at ¶ 32 (declining to adopt a limit on the amount of rate increase that may occur under the equipment averaging methodology, because "such a mechanism would undermine the uniformity of rates that equipment averaging seeks to obtain ....") (emphasis added). See also Uniform Rate-Setting Methodology, CS Docket No. 95-174 (released November 29, 1995), at ¶ 12 ("[F]acilitating an operator's ability to advertise a single rate for cable service over a broad geographic region may lower marketing costs and enhance the operator's efficiency in responding to competition from alternative service providers that typically may establish and market uniform services and rates without regard to franchise area boundaries").

[15] See Notice at ¶ 9. See also proposed amendment to 47 C.F.R. § 76.923(l) ("Such charges shall be set, consistent with

(continued ...)

installation costs/HSC will undermine this requirement. If equipment costs and installation costs are not averaged on the same geographic level, the result will be a disconnect between equipment cost aggregation and equipment pricing. For example, an operator might aggregate equipment costs at the national level yet, because of its inability to average installation costs at the same level as a result of the Commission's proposed limitation, be forced to establish a different price for the equipment for each franchise area.

c. Broad Geographic Averaging of Installation Costs Will have a *De Minimis* Impact on Equipment Lease Rates and Installation Rates.

While the Commission proposes to limit installation averaging because of the potential rate increases that will result for certain customers, it is important to stress at the outset that any such increases will be *de minimis* and that such averaging will also result in rate *decreases* for many customers.[16] Any rate increase will be *de minimis* for the reasons discussed below.

First, the establishment of a uniform HSC would change converter prices only slightly. For example, in TCI systems, a uniform HSC would change converter prices an average of only

(... continued)
the level at which Equipment Basket costs are aggregated as provided in § 76.923(c)").

[16] Of course, the entire process will be revenue-neutral for the cable operator.

+/- $0.10. TCI calculated this range as follows: TCI identified a system with an addressable converter lease rate of $2.75. This is the weighted average addressable converter rate for all TCI systems. TCI then recalculated this converter lease rate using first TCI's highest HSC ($34) and then TCI's lowest HSC ($16).[17] The resulting lease rate varied between approximately $2.85 using the $34 HSC and approximately $2.65 using the $16 HSC, for a range of +/- $0.10.

Similarly, the effect of installation cost averaging on installation rates will be modest. In TCI's systems, for example, this will mean, <u>at most</u>, an effective rate increase of approximately $0.15/month. This figure is derived as follows: The difference between TCI's lowest HSC ($16) and the weighted average HSC across all TCI systems ($23) is $7. Since installation of an initial connection in a pre-wired home typically takes 3/4 of an hour to complete, this $7 is multiplied by 3/4 to arrive at $5.25. Over the life of a typical customer who remains a customer for three years, this one-time $5.25 additional installation fee represents an effective monthly increase of only $0.15. Of course, this number becomes much smaller the longer the customer takes cable service and the

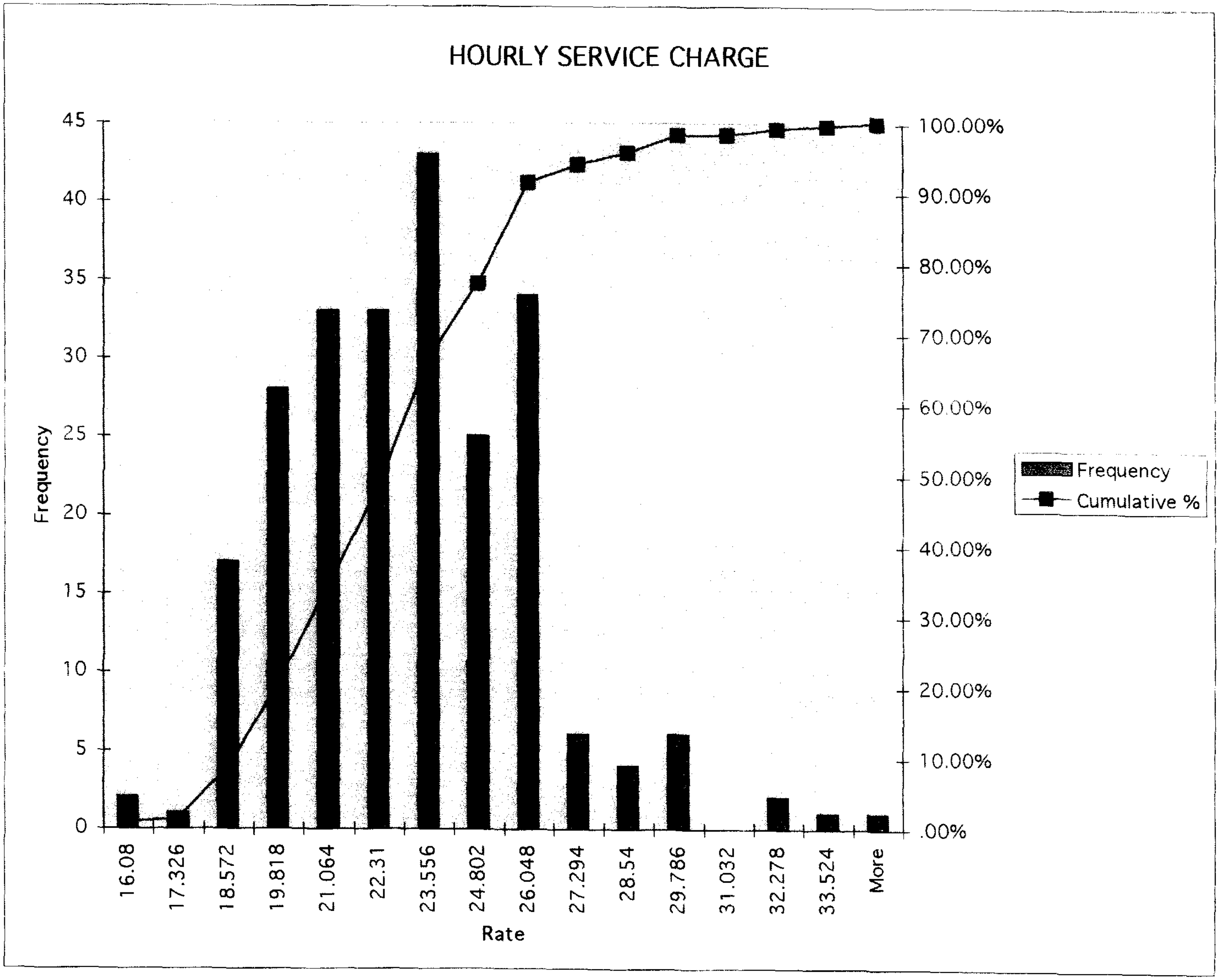
[17] A histogram of TCI's HSC for the company based on FCC Forms 1205 filed on March 1, 1996 is presented on the next page.

TELE-COMMUNICATIONS, INC.

HSC

HISTOGRAM

Rate	*Frequency*	*Cumulative %*
16.08	2	.85%
17.326	1	1.27%
18.572	17	8.47%
19.818	28	20.34%
21.064	33	34.32%
22.31	33	48.31%
23.556	43	66.53%
24.802	25	77.12%
26.048	34	91.53%
27.294	6	94.07%
28.54	4	95.76%
29.786	6	98.31%
31.032	0	98.31%
32.278	2	99.15%
33.524	1	99.58%
More	1	100.00%



closer the system's current HSC is to the $23 weighted average HSC.[18]

Finally, because TCI and other cable operators from time to time offer promotional and discounted installation rates to increase their customer base, any increase would be further reduced, if not eliminated, by the customer's taking advantage of such an installation discount.

IV. EQUIPMENT USED BY BASIC-ONLY CUSTOMERS

A. Categorical Averaging

Congress directed that basic-only customers not subsidize the costs of more sophisticated equipment used by non-basic-only customers. The Commission proposes to implement this directive by using the current rule which requires the costs of each significantly different type of equipment used by basic-only customers to be included in separate categories and not averaged with the costs of other equipment.[19]

TCI believes that the Commission's proposal represents a correct interpretation of the Act and that cable operators should have the option of implementing the basic-only exception using this approach. However, one point of clarification is required

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[18] For example, as TCI's HSC histogram shows, very few systems have an HSC lower than $18.57.

[19] See proposed amendment to 47 C.F.R. § 76.923(c)(2).

-- the basic-only exception applies to basic-only _customers_, not to basic-only _equipment_. Indeed, there is no such thing as basic-only cable _equipment_. Rather, the same piece of customer equipment may be used by both basic-only customers and non-basic-only customers. For example, while the substantial majority of basic-only customers who have a converter box have the "standard box" (_i.e._, a low-level extended tuner box), some basic-only customers may have a more advanced addressable box.[20] Similarly, a non-basic-only customer may use the same model standard converter that is also used by a basic-only customer if, for example, the non-basic-only customer simply needs the box for extended tuning since none of the CPST signals are scrambled. In light of this fact, the Commission should make clear that categorical averaging is permitted for equipment used by non-basic-only customers, even if the same equipment is also used by basic-only customers.

TCI also believes that an alternative approach for implementing the basic-only exception should be available to all operators. Under this approach, cable operators would be able to include equipment used by basic-only customers in a broad category as long as the categorical averaging is done based on an assumption that _all_ equipment in the broad category is the lowest

[20] This may be necessary, for example, in cable systems with dual cable in order to enable television sets to tune services from both cables.

level and most inexpensive model of equipment. Under this approach, some basic-only customers would see a decrease in their equipment rates; however, no basic-only customer would see an increase in its equipment rates as a result of this categorical averaging proposal.[21]

For example, assume a cable system has 100 customers, five of which are basic-only customers. Each basic-only customer has either a standard converter box or an addressable box. Under TCI's proposed approach, the operator would be permitted to assume that all of the five boxes in the homes of basic-only customers are standard boxes, even though any particular basic-only customer may have a higher-level box. The operator would then average the costs of five standard boxes across the selected geographic area to derive a uniform price for all boxes used by basic-only customers in that area.

Of course, this would create a revenue shortfall because basic-only customers with addressable boxes would have a lease rate based on less expensive standard boxes. However, the operator would recover this lost revenue when it created a pool

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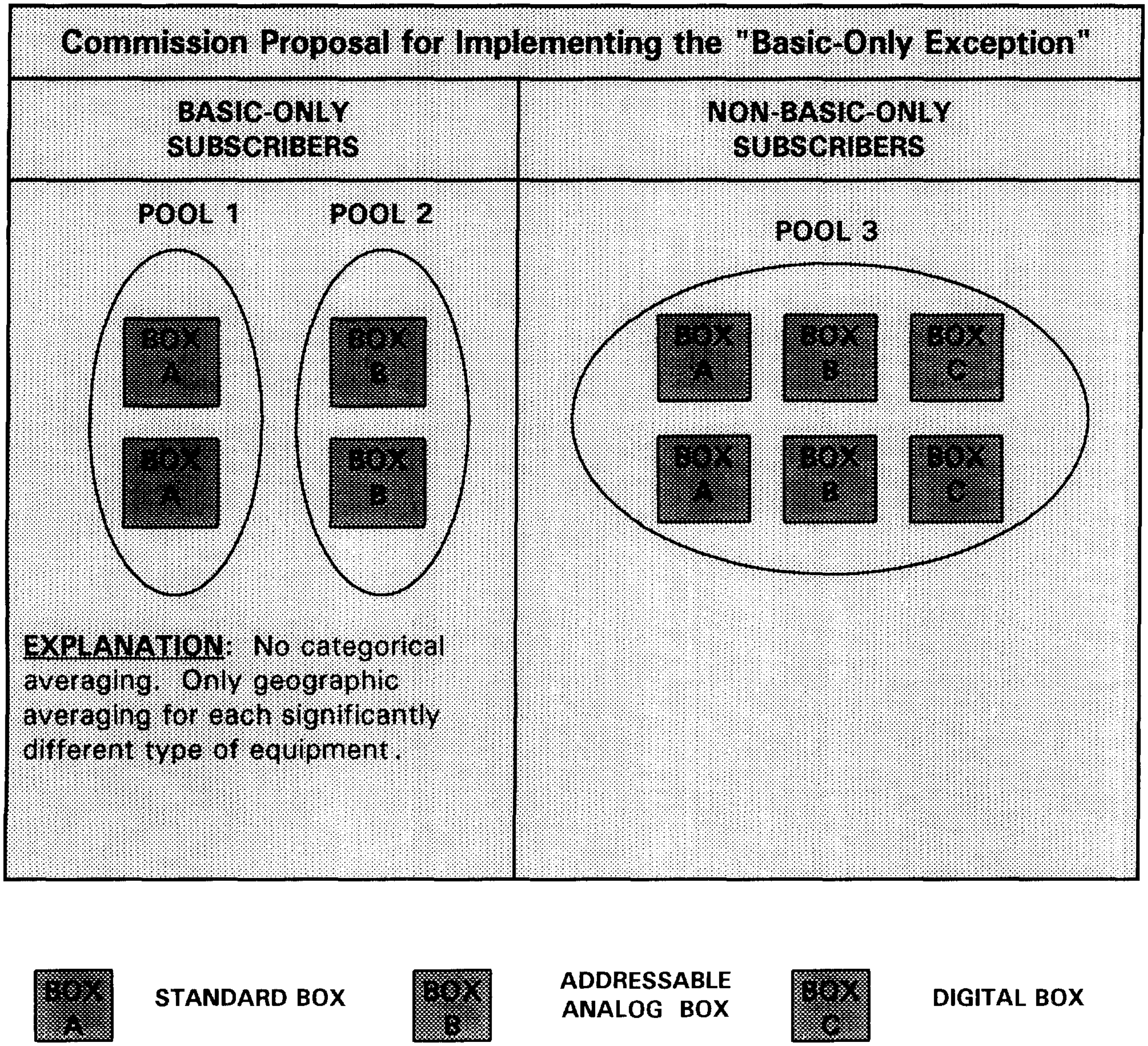
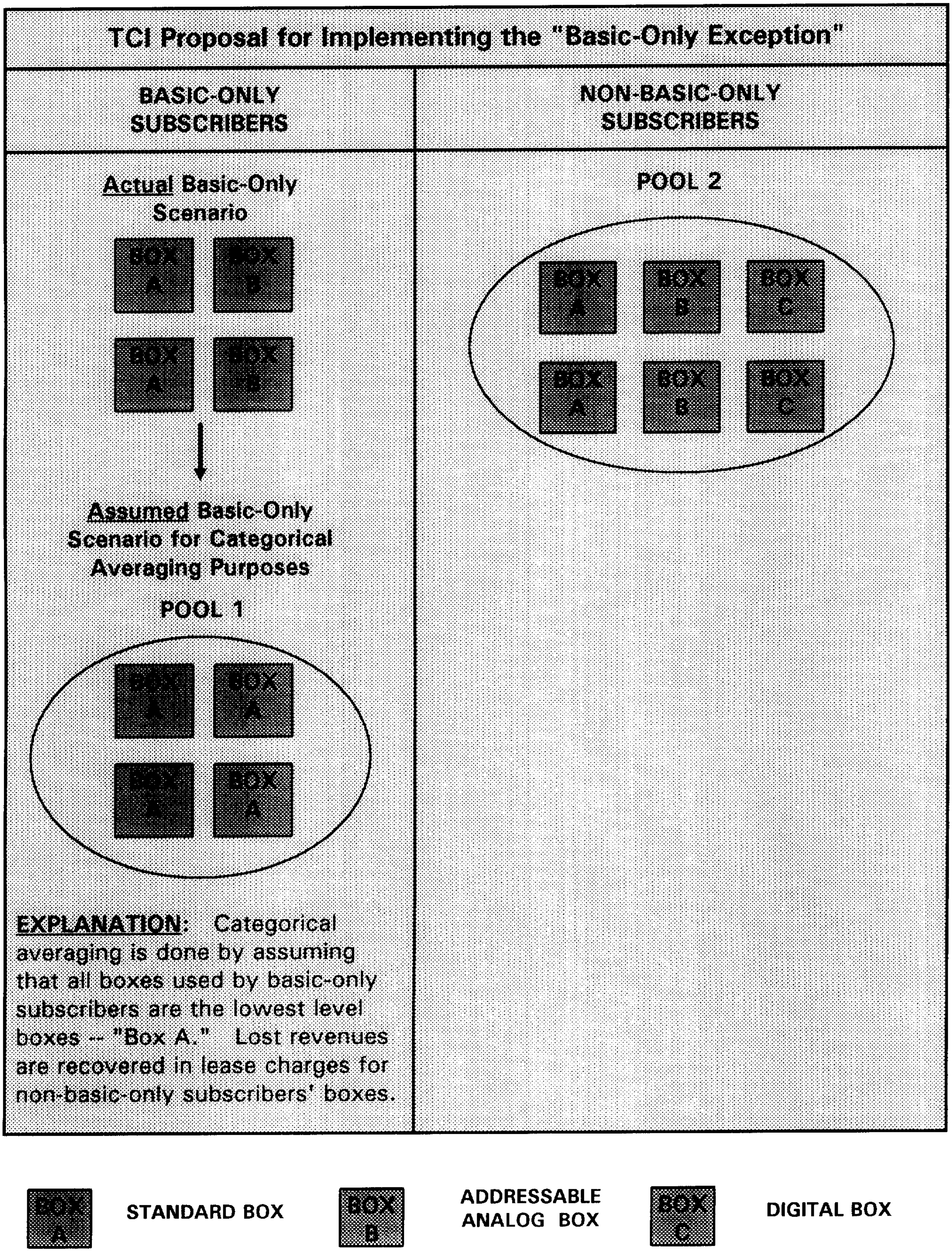
[21] While some rate increases may occur as a result of geographic averaging, any such rate increases will be de minimis and will be revenue-neutral for the cable operator. The Commission has previously recognized that rate increases that certain customers may experience as a result of revenue-neutral geographic averaging are justifiable for many reasons, not the least of which is that such averaging "will minimize drastic increases for customers as upgrades take place ...."). See Time Warner Social Contract Order, FCC 95-478 (released November 30, 1995), ¶ 40.

for averaging equipment costs of non-basic-only customers. Continuing the above example, suppose the cable operator has $100 in equipment costs and that three of the five basic-only customers have standard boxes and two have addressable boxes. A standard box costs $1 and an addressable box costs $3. Under TCI's proposed approach, the operator assumes that all five basic-only customers have a standard box. Thus, the total box cost attributed to the basic-only customers is $5 (i.e., five @ $1), even though the actual cost is $9 (i.e., three @ $1 and two @ $3). There is a shortfall of $4. However, when the operator creates a pool for averaging the equipment costs of the non-basic-only customers, it simply subtracts the assumed basic-only total (i.e., $5) from the total equipment costs (i.e., $100) and allocates the result (i.e., $95) to the non-basic-only equipment pool. Thus, the operator properly recovers the $100 equipment cost -- $5 from the basic-only averaging and $95 from the non-basic-only averaging.

The Commission's proposal based on the current "significantly different" test and TCI's optional alternative proposal are depicted graphically in the charts on the following two pages.[22]

[22] Of course, if the Commission adopts TCI's alternative proposal, it would have to amend its proposed amendment to 47 C.F.R. § 76.923(c)(2) to make it clear that categorical averaging of equipment used by basic-only customers is permissible, as long as it is done pursuant to the methodology described above.


Commission Proposal for Implementing the "Basic-Only Exception"
BASIC-ONLY SUBSCRIBERS
NON-BASIC-ONLY SUBSCRIBERS
POOL 1
POOL 2
POOL 3
BOX A
BOX A
BOX B
BOX B
BOX A
BOX B
BOX C
BOX A
BOX B
BOX C
EXPLANATION: No categorical averaging. Only geographic averaging for each significantly different type of equipment.
BOX A
STANDARD BOX
BOX B
ADDRESSABLE ANALOG BOX
BOX C
DIGITAL BOX


TCI Proposal for Implementing the "Basic-Only Exception"
BASIC-ONLY SUBSCRIBERS
NON-BASIC-ONLY SUBSCRIBERS
Actual Basic-Only Scenario
BOX A
BOX B
BOX A
BOX B
Assumed Basic-Only Scenario for Categorical Averaging Purposes
POOL 1
BOX A
BOX A
BOX A
BOX A
POOL 2
BOX A
BOX B
BOX C
BOX A
BOX B
BOX C
EXPLANATION: Categorical averaging is done by assuming that all boxes used by basic-only subscribers are the lowest level boxes -- "Box A." Lost revenues are recovered in lease charges for non-basic-only subscribers' boxes.
BOX A
STANDARD BOX
BOX B
ADDRESSABLE ANALOG BOX
BOX C
DIGITAL BOX

There are several reasons why the Commission should adopt TCI's optional approach. First, it complies with section 301(j), since no basic-only customer would "subsidize the costs of more sophisticated equipment used by customers taking services in addition to basic."[23] In fact, as noted, some basic-only customers who currently use more sophisticated equipment will actually see a rate decrease due to this categorical averaging approach.

Second, the costs that would be allocated to the second pool as a result of this categorical averaging approach would result in only a modest price increase for boxes used by non-basic-only customers. This is due to the fact that there are typically very few basic-only customers (usually around 3-6% of all customers), and most of these customers use the lowest level standard box, to the extent they use a box at all.[24]

Finally, TCI's proposed approach would create substantial administrative, marketing, and regulatory efficiencies. By allowing cable operators to create two geographically averaged prices for its boxes -- one standard box price for equipment used by basic-only customers, and one for boxes used by all other

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[23] See Notice at ¶ 13.

[24] In this sense, TCI's proposal works much like the restructurings to create Lifeline basic service tiers which the Commission has approved in the Social Contract context.